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## E-CONSOLIDATION

### Shakeout in trading sites and network hubs brings needed clarity to chemical e-commerce

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**It's been hard to see the forest for the trees. Just about a year ago, chemical industry e-business real estate was thick with dot-coms and sprouting company networks.**

Since then, nearly half of them have fallen, merged, or changed focus as the industry responded in how it's willing to conduct business online. Now, with the landscape cleared, a few stalwarts may be positioned to finally advance chemical e-business toward its previously anticipated heights.

"Adoption is really a huge issue, and part of that hurdle has come from a lack of clarity in the marketplace," says Steven J. Kafka, research director for business trade at Forrester Research. "There

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are a significant number of companies that are waiting it out until the confusion clears."

Consolidation among dot-coms is helping to clear up some of that confusion, Kafka believes. In the biggest deal to date, ChemConnect completed its acquisition of rival trading website CheMatch.com earlier this month. Since the recent demise of much of Enron's trading through its EnronOnline site, ChemConnect has emerged as the only significant website for chemical commodity, spot-market, and related financial trading, analysts say.

ChemConnect and CheMatch together saw $4 billion worth of transactions on their websites in 2001. Kafka considers this to be on track for the expected growth in online chemical trading and a significant amount after 18 months of operation.

"The key issue has been the need to get liquidity"--transactional movement--on a site, Kafka says. "There is just not enough out there for all the players to have been independently successful."

With two or more sites, buyers and sellers also ran the risk of not meeting up. "The combination makes a lot of sense, certainly for the customers, because they are better off having a single site to use," he continues. "It also means that the business should take off much more quickly now."

**ALTHOUGH ANALYSTS** didn't expect that multiple trading sites could have survived long term, neither ChemConnect nor CheMatch was believed to be in imminent trouble. ChemConnect had the upper hand with more money, members, and industry investors, and triple the transaction value. CheMatch, analysts say, had stronger technology and a clear focus on commodities.

"It took a lot of courage and compromise on both sides to make this happen," says Leif Eriksen, an analyst with AMR Research. "It would have been easier to try to outlast one another. But the value now is much greater than it would have been later on when one ran out of cash and the other was trying to pick up the pieces."

John K. Robinson, chief executive officer of ChemConnect, affirms that a common desire to increase the rate of adoption through one site drove the deal. "Previously, people had to decide not only whether to use e-commerce," he says, "but also were confronted with the decision of with whom to work, who provides the best service, and who's going to be around.

"It's now just a decision of do you want to adopt e-commerce or not," he points out. "Our real competition is the old, inefficient

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way of doing business." Robinson, a former chemical executive who led BP Chemicals' e-business initiatives, joined ChemConnect as CEO in late 2000.

Cost savings from merging the two operations were an important driver. Integrating technology platforms and relationships with logistics, credit, and other suppliers should cut costs. ChemConnect has moved headquarters from San Francisco to CheMatch's less expensive offices nearer the customer base in Houston. It is paring the combined staff of 160 down to just 75 to 80.

## CONSOLIDATION

**ChemConnect and CheMatch to combine online trading operations**

| | CHEMCONNECT | CHEMATCH |
|---|---|---|
| Founded | 1995 | 1997 |
| Headquarters | San Francisco | Houston |
| Employees | 120 | 40 |
| Members | 7,500 | 860 |
| Volume traded, 2001 | 6 million metric tons | 4 million metric tons |
| Transaction value, 2001[a] | $3 billion | $1 billion |
| Total funding raised | $130 million | $50 million |
| Investors[b] | 55 | 13 |
| Initial stock offering filing/withdrawal | April 2000/July 2000 | March 2000/October 2000 |
| Major events | Acquired Universal Chemical Brokerage in October 2000. Merged with Envera chemical company network in June 2001. | Acquired Energy Group brokerage in late 2000. Launched futures trading with Chicago Mercantile Exchange in October 2001. |

a Estimates. b Includes major chemical companies, consulting and technology firms, and venture capital investors.

**AN INTEGRATED** trading exchange site will emerge by early March, Robinson says, and he expects the value of transactions to double this year. Robinson also conveys urgency about having a positive cash flow and reaching profitability quickly. "We're confident that we're going to be profitable by the end of this year," he says, "and that's at least a year earlier than it would have been for ChemConnect without this combination."

While profitability is obviously an important milestone for employees and shareholders, he believes it is most important for ChemConnect's customers. "We have a very solid financial situation right now," he says, "but there is nothing like robust profit performance to assure them of the sustainability of the business."

Although ChemConnect has basically followed its original business plan for providing a chemicals trading platform along with negotiation tools--such as auctions and private trading rooms--its revenue model has shifted. It will still charge transaction fees on commodity trades, but most other services are by subscription. It can size subscriptions appropriately for users, Robinson explains, and promote broader use because they won't

have to make a decision about the incremental cost with each transaction.

Kafka says the subscription model makes sense for the kind of business targeted by ChemConnect or by Elemica, the transaction hub backed by a group of chemical company investors. "They are not going to be able to charge very much in transaction fees because the margins in chemicals are already so small that companies are just not willing to give that up on a trade-by-trade basis," he explains. "And they need to have an up-front and recurring revenue stream they can count on to be viable businesses."

It was a fallacy to believe that electronic marketplaces, although processing billions in transactions, were ever going to be large businesses, Kafka adds. Instead, he suggests, "they may be nice tidy little businesses of $50 million or $100 million in revenues" that will support smaller operations.

Robinson says ChemConnect has extended its products and services in response to customer feedback. Initially focused on spot-market trades, a significant portion of its business is helping companies with negotiation tools and connectivity capabilities for long-term contracts.

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**"There are a significant number of companies that are waiting it out until the confusion clears."**

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**CUSTOMERS ARE NOW** asking for self-service auctions and risk management tools, Robinson says. "Our customers now understand how to structure and conduct auction events, so they want to use our platform but don't always need full support," Robinson says. One benefit of the self-service option will be lower costs, but Robinson also expects companies to increase their use of auctions as they become "a more routine part of buying and selling chemicals."

If ChemConnect sees the expected increase in business on its trading floor, both the firm and analysts believe the added liquidity may help support the development and use of risk management tools. "Forward-thinking companies are understanding now that protecting margins and profits through risk management is not just an attractive concept but, with liquid physical trading markets as the foundation, is actually practical," Robinson says.

He says ChemConnect will support the relationship CheMatch developed with the Chicago Mercantile Exchange (CME). Unlike the energy industry, the chemicals business doesn't have a derivatives marketplace--a standardized commodity in which all other products can be traded. In October 2001, CheMatch and CME launched the first benzene and mixed xylenes futures contracts that also could be traded electronically.

ChemConnect also will offer CheMatch's Market Trak, an online service designed for monitoring prices and market conditions for specific commodity chemicals, feedstocks, and fuel products. Risk management products--such as futures, swaps, or other price contracts or hedges--are based on transparent, timely, and reliable pricing information.

"We have an opportunity to provide the kind of physical liquidity needed to generate a price index against which people can measure future prices and determine future settlements," Robinson says. "The reluctance to use risk management has not been that companies don't appreciate the concept, but the implementation has been impossible without a large liquid--and it turns out, electronic--trading market."

EnronOnline had begun playing a significant role here before its parent imploded. Already a major trader of energy and commodity futures and hedges, the company had branched out into petrochemicals and plastics. In 18 months of operations through May 2001, it had completed 1 million transactions online at a nominal value of more than $590 billion.

## EXPANSION

### Elemica's Network Grows

**CONNECTED:**
**Air Products, Atofina,** Basell, **BASF, Bayer, Celanese, Ciba Specialty Chemicals, Degussa, Dow Chemical, DSM, DuPont,** Procter & Gamble, **Rhodia, Rohm and Haas, Shell Chemical, Solvay,** Zeon

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**BEING CONNECTED:**
Akzo Nobel, Biesterfeld, **BP Chemicals, Brenntag, ChemCentral**, Clariant, Crompton, CSC JäkleChemie, Flexsys, H.B. Fuller, Infineum, PPG Industries, Syngenta, **Vopak**, Yule Catto

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**OTHERS:**
**Millennium Chemicals, Mitsubishi Chemical, Mitsui**

**Chemical, Sumitomo Chemical,** 14 committed to become members

**NOTE:** Original investors are shown in bold.

"**ENRONONLINE** provided liquidity since it was willing to both buy and sell--that is, take the position of other participants--and keep trading going," says Jim Walker, Forrester Research senior analyst. "Without that 'market maker' and sufficient deal flow, it's hard for nascent commodity marketplaces to get going."

However, Walker believes there's a separate and more fundamental problem when it comes to chemical companies accepting risk management. "Most transactions are between companies that know each other well and have long-term relationships," he explains. "They aren't necessarily interested in more than the physical transaction through contracts governed by price formulas that have been in place for a long time."

Chemical companies have displayed this preference by using sites such as ChemConnect more for private negotiation than trading, he says. "They aren't necessarily looking for a spot market that provides a great deal of price transparency," he continues.

Enron might have had the effect of forcing companies to overcome this reluctance and drive them to look for better deals online, Walker says, if EnronOnline had accepted very narrow margins between buying and selling prices and increased liquidity and price transparency.

UBS Warburg, the investment banking arm of Swiss financial group UBS and one of Enron's creditors, recently acquired Enron's North American energy trading operations. In exchange for royalties, but no up-front money, Enron is providing technology infrastructure and intellectual property. Online operations were relaunched earlier this month as UBSWenergy.com.

The online assets were the heart of the deal, Walker says, and he expects UBS to stay focused on energy markets and the challenge of rebuilding natural gas trading operations, where there are competitors. Prospects for branching out into petrochemical trading are unlikely this year, or even next, he adds.

However, just mid-February, former Enron commodity trading and risk management employees launched Mobius Risk Group with support from the nonprofit Resource Alliance Group in Houston. Mobius will offer risk management outsourcing and

advisory services to industries including petrochemicals.

Other companies--including Shell Chemical Risk Management, Koch Industries, and Louis Dreyfus--have been trying to sell the chemical industry on risk management for years. However, Walker and other analysts don't expect them to try to fill the gap left by EnronOnline in the short term.

"They saw how Enron was burned by going outside the energy industry," Walker says. "And there's still the underlying problem that many chemical companies don't want to admit that their commodity chemicals are commodities and have them traded as such. They prefer these contractual relationships with the price formulas."

Contractual relationships have been the primary focus of industry hub Elemica since its creation by 22 leading chemical companies in August 2000. The hub devotes itself to the nearly 50% of chemical business that is repeat contract orders. By making a single connection to the hub, a company can transact with all other linked buyers and sellers. Sellers can subscribe at different levels based on the number of deals they transact, while buyers are being offered modest incentives to join.

Elemica has about 43 companies committed to its network and, within the past three months, has doubled to 17 the number of them that have their enterprise resource planning (ERP) systems connected and transacting, says Dennis Campbell, chief operating officer for the Americas. "Proof of concept," he says, has helped Elemica tap into "pent-up demand."

"Now that companies are seeing enough trading partners there, they are rapidly joining on," Campbell says. He and others say economic conditions, uncertainty about e-business, and other factors slowed investment and adoption to a crawl last summer.

Though more companies are linking, not all are fully prepared practically, or even psychologically, for heavy volumes of online transacting. "A few significant companies are still on the fence," AMR's Eriksen points out, having not joined Elemica or ChemConnect.

The contractual transaction side of e-business has grown more slowly than originally anticipated, Kafka says. "The adoption problem here is more one of back-end integration--companies are not going to get the real benefit of online trading or collaboration around the supply chain until they actually connect their back-end systems, and that's hard and

expensive to do."

Campbell

Robinson

While admitting that chemical companies are cautious about change and adopting new technology, Campbell believes they understand the hub's value. Elemica says it anticipates this value to be lower supply-chain and technology costs, increased efficiency, and less manual intervention in order processing.

"We have clearly established the viability of the information technology connection," Campbell says. "The issue centers around overall adoption and whether companies will actually change some of their work processes." Realizing that it is still early for its business model, Elemica works to help them understand the changes they need to make to get the benefits from connecting.

Still, Elemica is optimistic; it has enough cash on hand to fund operations, thinks it could have 100 companies on its network by midyear, and expects to reach breakeven late this year. "We remain very focused on adoption," Campbell says. "We need to keep driving this network, and the stronger it gets the sooner our members can take real costs out of their systems and focus on value-added activities like product research or design."

**ELEMICA ALSO** expects to provide connections and needed data translations between hubs in other industries, many of which are downstream chemical customers, such as Covisint in the automotive area and Transora in consumer products. "It's all about simplifying the supply chain," Campbell says. "Even though slightly over 50% of buying and selling is within the industry, that means very close to 50% goes outside, so we have to drive our model to take care of that."

In August 2001, Elemica acquired ElastomerSolutions.com, adding six members as well as the elastomers community site. It then created a hub-to-hub connection with Transwide, a European network of 35,000 logistics firms, in December 2001, followed by an alliance with Omnexus, created by 20 plastics suppliers for their customers. Earlier this month, Elemica agreed to a connection with Quadrem, an e-marketplace for mining, minerals, and metals industries backed by about 20 major firms.

Besides talking with other hubs, Elemica is "also reaching out to the critical players in other industries," Campbell says. For example, although a leader in Transora, Procter & Gamble, which Campbell says buys about $8 billion worth of chemicals annually, has joined Elemica directly.

With ChemConnect's emergence as the primary spot market and commodity trading site, speculation has increased about its relationship with Elemica. The two also share at least 12 major chemical company investors, which may either complicate or simplify matters, depending on the growth and direction of the separate businesses.

In June 2001, ChemConnect acquired Elemica's only major, albeit smaller, competitor, Envera, which now links 14 trading partners. "A competitive scenario could develop down the road," Eriksen says. "Once ChemConnect is profitable with its core business, I expect it will look at other sources of revenue for growth, and supply-chain services would be one area to consider."

Two weeks ago, ChemConnect joined with GE Operation Services, part of General Electric, to begin offering ERP inventory tracking and management tools and services for its members.

**"Companies are not going to get the real benefit of online trading or collaboration around the supply chain until they actually connect their back-end systems, and that's hard and expensive to do."**

**"THE MARKET IS** big enough that Elemica and ChemConnect can coexist," Kafka says, "but it will require that ChemConnect decide it's going to be in the commodity end of the market." Right now, he says ChemConnect still wants to offer end-to-end chemical e-business solutions, including the supply-chain management and ERP connectivity capabilities that are Elemica's province.

"Elemica has the commitment of the big players, and they are not going to just let those investments go by the wayside," Kafka warns. "So I think coexistence is where we're headed, with ChemConnect becoming a spoke in the Elemica hub."

While Elemica's Campbell is circumspect about any future relationship between the two operations, ChemConnect's Robinson says he sees opportunities. "The efficiency of the members of both Elemica and ChemConnect would be improved by a connection of the two hubs, and that's certainly something we're prepared to do," he says, along with connecting to other hubs. "The more we can automate through hub-to-hub connections, the more we'll drive down the cost of doing business and make all industries more competitive."

Consolidation has helped prune out an overabundance of e-marketplaces for chemicals, Kafka says. Although many are still left, he and other analysts view them as very specialized, in small niches, or mom-and-pop operations, probably ripe for more consolidation.

"It's not that they aren't offering valuable services, but in terms of the size and viability of the business opportunity, I just don't think they stand up," Kafka says. "The story that ChemConnect can tell about providing a liquid market for commodities trading, or that Elemica can tell about providing ERP connectivity, is what is resonating with customers."

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**Overview**
Elemica offers a broad range of functionality that enables inter-company commerce. Our solutions bring value to buyers and sellers of chemicals as well as industry service providers. Through the Elemica Connected Solution, Web and Supply Chain Solutions, Elemica provides value to our clients by automating business processes such as the buying and selling of chemicals and then extends the value of that connection by creating new marketing channels and efficiency opportunities via our web solutions and supply chain offerings.

To learn more about the value of each of our products, please click on a link below.

ERP Connectivity
**Elemica Buyer Direct**
**Web Solution: Elemica Seller Direct**
**Supply Chain Overview**
**Supply Chain Planning**
**TransLink™**

**ERP Connectivity**
Enterprise Resource Planning (ERP-to-ERP) - connected communications between trading partners is a major driver of efficiency in the chemical industry and the backbone of the Elemica Network. ERP-to-ERP communications are seamless data exchange flows that facilitate transactions in areas such as order management, planning, and logistics. An ERP connection to the Elemica Network improves your businesses bottom-line by automating manual processes. By connecting to Elemica, your company benefits from greater efficiencies and lower industry supply chain costs. Connection maintenance costs are held at a steady and manageable level for all ERP connections; no matter how many trading partners you link through the Network. The Elemica Connected Solution product delivers business benefits designed to:

- Realize cost savings from standardizing and automating information exchange
- Ensure adherence to business rules with increased accuracy and reliability in every transaction
- Reduce errors, improving the quality of the information in business systems
- Create closer customer relationships

ELEMICA

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**Executives**

**Kent Dolby**, President and Chief Executive Officer
**Stewart McCutcheon**, Chief Technology Officer
**H. Juergen Weyh** , Senior Vice President Europe, Middle East, Africa
**Scott duFour**, Senior Vice President, Integration Solutions
**Alok Saxena**, Vice President Product Development
**Scott Miltenberger**, Vice President Finance and Administration
**Bradley Delizia**, Vice President and General Counsel

**Overview**

Elemica is the premier global neutral information network built to facilitate the order processing and supply chain management of contract and repeat chemical transactions. The company offers an integrated suite of product solutions that enables buyers and sellers of chemicals to streamline their business processes and to collaborate to achieve substantial savings.

**Key Dates**

- January 2001: First web based transaction takes place on 01/01/01 at 1:11am
- April 2001: ERP-Connectivity available to member companies - Elemica Connected Solution™
- May 2001: ElastomerSolutions Selects Elemica to Expand Service
- June 2001: First Commercial ERP-Connected Transaction made by BASF,Dow Chemical Company, DSM, and Solvay
- August 2001: Elemica celebrates one year anniversary of incorporation (August 17, 2000)
- October 2001: Elemica Supply Chain Solutions and Elemica Web Solutions available to member companies
- November 2001: Elemica and Transwide Join Forces
- December 2001: Omnexus and Elemica announce strategic alliance
- February 2002: Elemica and Quadrem form Hub-to-Hub Connection
- April 2002: Elemica Releases Version 4.0 of the Elemica Connected Solution
- June 2002: Elemica and Rubber Network Create Hub-to-Hub Connection
- October 2002: Elemica and Optimum Logistics Announce Strategic Agreement
- December 2002: DSM first company to use Elemica - ATPlan Telemetry Services
- March 2003: Elemica acquires Optimum Logistics
- June 2003: Elemica opens Singapore Office

**Products/Services**

- Elemica Connected Solution - "Connect Once - Connect to All" ERP Connectivity
- Elemica Buyer Direct - light integration connectivity for buyers
- Elemica Web Solutions - Elemica Seller Direct

- Elemica Supply Chain Solutions - Supply Chain Planning; Vendor Managed Inventory (VMI); Collaborative Planning, Forecasting and Replenishment (CPFR); and Supply Chain Optimization
- Elemica TransLink™ Solution (Logistics)- Transportation Arrangement, Track & Trace and Transportation Optimization

**Investing Member Companies**

- Air Products and Chemicals
- ATOFINA
- BASF
- Bayer
- BP
- Brenntag
- Celanese
- CHEMCHENTRAL
- Ciba Specialty Chemicals
- Degussa
- The Dow Chemical Company
- DSM
- DuPont
- Millennium Chemicals
- Mitsubishi Chemical Corporation
- Mitsui Chemicals
- Rhodia
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